



State of Utah
GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

Labor Commission

JACSON R. MAUGHAN
Commissioner

CHRISTOPHER C. HILL
*Deputy Commissioner and
General Counsel*

August 31, 2017

Governor Gary R. Herbert
Senator Curtis S. Bramble
Representative James A. Dunnigan

To Governor Herbert, Senator Bramble, Representative Dunnigan, and the members of the Business and Labor Interim Committee.

This is the seventh annual report from the Worker Classification Enforcement Council ("Council"), submitted pursuant to U.C.A. § 34-47-202. In the year since the Council's August 2016 report, the Council has continued to meet on a quarterly basis. Agenda and Minutes for all Council meetings are available on Utah's Public Notice Website.

The Nature and Extent of Misclassification in Utah

Misclassification of employees continues to be an issue requiring attention in Utah. In addition to the chronic problem of some employers attempting to treat their employees as independent contractors, the Council continues to see constantly shifting schemes by certain employers who seek to circumvent their responsibilities under the law. Among others, the Council continues to see companies inappropriately using the owner-worker model to misclassify employees. Industries where misclassification continues to be a concern include professional services, construction, and transportation. Through misclassification, employees are denied the wages they have earned and are denied the protections afforded by workers compensation and unemployment insurance. Law-abiding employers are disadvantaged by dishonest employers who, by skirting the law, create an unlevel playing field. And, Utah citizens suffer lost tax revenue because of employers not complying with the law.

As detailed in this report, over the last year the Council has continued its efforts to cooperatively investigate and address worker classification issues. The efficiency of information sharing and referrals continues to improve between Council member agencies. Investigations, enforcement actions, collection of penalties and fines, and obtaining agreements from offending employers to comply with the law have all been successfully pursued. Each member agency and the Attorney General continue to view the Enforcement Council as an effective body in addressing misclassification of workers in Utah.

Results of Regulatory and Law Enforcement Efforts, and the Status of Sharing Information by Member Agencies

The Labor Commission

Since 2012 the Utah Labor Commission (the “Commission”) has maintained a web page explaining worker misclassification issues in the State of Utah. The web page defines employee misclassification, describes the negative impacts it can have across all facets of society and educates the public on how to file a complaint of misclassification with the Commission. The Commission has also monitored a misclassification hotline since 2012 and has received a number of misclassification complaints through the hotline.

The Commission is responsible for ensuring each employee in the State of Utah is covered by workers’ compensation coverage. When the Commission receives a misclassification complaint, either directly or as a referral through one of the Council’s member agencies, the Commission’s Industrial Accidents Division (the “IA Division”) investigates the complaint to ensure the employer carries appropriate workers’ compensation coverage for its employees. The IA Division also conducts internal investigations on hundreds of employers each year to ensure compliance with workers’ compensation requirements. The Commission has assessed and collected thousands of dollars in penalties against noncompliant employers based on misclassification complaints and referrals, as well as these internal investigations.

The Commission reviewed 119 specific complaints of misclassification for workers’ compensation compliance during fiscal year 2017. These complaints were received primarily through the hotline, or were referred from the Department of Workforce Services and other agencies. Some of the complaints were received from the Commission’s Wage Claim Unit or from the Commission’s Occupational Safety and Health Divisions and arose during investigations performed by these divisions. After investigation, the IA Division found the employers to be noncompliant with workers’ compensation requirements in 66 of these cases. The Commission assessed penalties in the total amount of \$5,311,228.55. Most of these parties appealed the determination or otherwise entered into a negotiated settlement with the IA Division. After appeal or settlement, the final penalties assessed in these 66 cases amounted to \$4,537,860.04.

Of the 119 cases reviewed by the IA Division, 33% involved employers engaged in the professional services industry, which includes employers providing health services in either a home or an office setting. Eight percent (8%) of these cases involved employers engaged in the construction industry. Employers engaged in the transportation industry comprised another 11% of these cases.

The Commission, like the Council’s other member agencies, shares with the other member agencies of the Council the misclassification complaints it receives, the results of subsequent investigations, and the results of its internal investigations. This ability to share information between member agencies has been and continues to be critically important to the Council’s work in addressing employee misclassification in Utah. The

Commission feels the Council remains an effective tool in addressing employee misclassification in Utah.

The Department of Commerce

The methods of worker misclassification that the Department of Commerce continues to encounter include the following:

- (1) Companies inappropriately classifying employees as “owners”;
- (2) Contractors inappropriately paying workers as independent contractors rather than employees;
- (3) Contractors accepting 1099 payments to avoid payroll taxes and to avoid reporting to governmental agencies either as employees or independent contractors.

During the last year, based on information obtained from the Utah Department of Workforce Services, the Department through its Division of Occupational and Professional Licensing (DOPL) has taken action against Accelerated Construction Enterprises LLC dba Ace I.N.V. LLC (“Ace”) a licensed contractor that hired hundreds of independent workers without classifying, registering, and fulfilling their corresponding unemployment insurance requirements as appropriate for individuals who should be W-2 wage employees. Ace claimed to have completed the filing of tax returns for the 2012-2014 period and filed a written response with DOPL which included their purported income tax returns for those years. Ace claimed total gross receipts on its income tax returns (prior to expense deductions) of \$0 for 2012, total gross receipts of \$0 for 2013, and total gross receipts of \$231,890 for 2014. Based upon audits of other contractor companies, and upon review of the response documents provided by Ace, DOPL determined that 2012-2014 tax returns as submitted were both inaccurate and incomplete. Based upon the evidence obtained from just a few audits of contractors using Ace as a subcontractor, DOPL discovered that Ace had been paid in excess of \$8,105,079 during the period of 2012-2014, yet claimed gross receipts on its tax returns of only \$231,890 for the same time period, and therefore had underreported gross receipts on its business tax returns during the period of 2012-2014, in an amount in excess of \$7,873,189. The Department pursued agency action to revoke Ace’s license as a contractor. In March 2017, Ace eventually stipulated to the revocation of its contractor license.

Additionally, the Department has continued to investigate, audit, and proceed with agency action against independent workers of ITY of Texas that were paid as 1099 independent contractors but were not licensed contractors. As a result, to date, the Department has pursued agency action and fines against approximately 650+ unlicensed independent workers.

In August 2014, the Department hired a full-time auditor to perform financial audits of contractor licensees and to investigate the payment practices and labor

misclassification within the construction industry in the State of Utah. This was a newly created position aimed at addressing misclassification.

Thus far this auditor's efforts have resulted in the following:

- 667 opened cases;
- 645 closed cases;
- 394 cases closed with administrative sanctions including fines, probation, and/or revocation of licensure;
- \$222,300 in fines through signed stipulations and orders;
- 3 cases with outstanding stipulation offers; and
- 30 licensees on probation being monitored.

The Department of Commerce continues to benefit from information that has been exchanged through the Worker Classification Coordination Enforcement Council. This exchange of information with other agencies has assisted the Department of Commerce to take action against contractor licensees that are not complying with employee classification, hiring, and payment requirements. The Department of Commerce's actions against these contractors have assisted the Department of Workforce Services in its collection efforts for the Unemployment Insurance Fund.

The Department of Workforce Services

The Department of Workforce Services Unemployment Insurance Division (DWS/UI) completes both "random" and "targeted" audits on Utah employers.

During fiscal year 2017, a total of 847 random audits were completed. Findings for the year include a total of \$8.2 million in unreported wages and 2195 misclassified workers; an average of 2.6 misclassified workers per audit. (Compared to a total of 854 random audits, \$7.5 million in unreported wages, and 961 misclassified workers; an average of 1.1 misclassified workers per audit during 2016.)

During fiscal year 2017, a total of 335 targeted audits were completed. These audits primarily use information from the IRS Form 1099 to identify potential unreported workers. Findings for the year include a total of \$48.3 million in unreported wages and 4,874 misclassified workers; an average of 14.55 misclassified workers per audit. (Compared to a total of 379 targeted audits, \$47.3 million in unreported wages, and 5,912 misclassified workers; an average of 15.6 misclassified workers per audit.)

The random and targeted audit results demonstrate that the vast majority of registered Utah employers are reporting workers properly, with less than half of all audits resulting in a change to the original wage reports. However, there continues to be an issue with worker misclassification in Utah and across the nation. In recent years, DWS/UI has focused more of its audit resources on targeted audits to increase employer compliance.

The U.S. Department of Labor (DOL) has issued repeated guidance to all state UI agencies that worker misclassification detection and enforcement is a priority. Since 2011, DOL has calculated an Effective Audit Measure Score for each state. The DOL measure is comprised of four factors: 1) Percent of employers audited annually; 2) Percent of total wage change from audit; 3) Percent of total wages audited; and 4) Average number of misclassifications detected per audit. DWS/UI achieved an effective audit score of 15.5 for the year ending December 31, 2016, surpassing both the minimal acceptable score of 7 and national aggregate of 10.8.

DWS/UI continues to work with the Council partners in addressing this issue. Commerce coordinates investigations with DWS/UI when contractors are violating unemployment insurance laws. As a direct result of this partnership, DWS/UI collected \$197,885 in past-due contributions from 68 Utah employers in calendar year 2016. The Labor Commission refers investigations from their hotline number and Worker's Compensation investigations. The Tax Commission also identified and referred numerous instances where employers issued Internal Revenue Service W-2 forms to employees that were not properly reported to DWS/UI.

DWS/UI employees also referred just over 105 unemployment insurance audits to Commerce, Labor Commission, and Tax Commission, identifying about 5,320 workers who were determined to be employees, not independent contractors.

The collaboration facilitated through this Worker Classification Enforcement Council continues to support DWS/UI goal of detecting worker misclassification and enforcing state laws that ensure qualified workers receive unemployment insurance coverage.

The Tax Commission

The Tax Commission continues to benefit from the referrals it receives from the different agencies that participate on the Enforcement Council. We have found that a large number of employers who have been audited by the Labor Commission, Department of Commerce and Department of Workforce Services will voluntarily register with the Tax Commission as an employer with employees. Those who do not register voluntarily are notified by the Tax Commission to register their business. The Compliance staff in the Auditing Division follows up on this requirement. There are times when the Tax Commission will refer cases to the IRS for prosecution when it appears that the actions of the employer are deemed criminal. These referrals open the door for the IRS to work jointly with the different agencies to obtain investigative reports and records to enhance their case. The Enforcement Council has been a very effective tool for all agencies involved.

Recommended Legislative Changes

The Council appreciates the attention the Legislature has given to worker classification issues. The Council has no specific recommendations for the 2018 legislative session.

We look forward to continuing to report annual progress, and are glad to provide any other requested information or answer any questions.

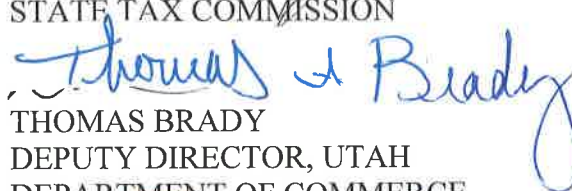
Sincerely,



CHRISTOPHER C. HILL
CHAIR, WORKER CLASSIFICATION
ENFORCEMENT COUNCIL
DEPUTY COMMISSIONER, UTAH
LABOR COMMISSION



DOLORES FURNISS
DISCLOSURE OFFICER, UTAH
STATE TAX COMMISSION



THOMAS BRADY
DEPUTY DIRECTOR, UTAH
DEPARTMENT OF COMMERCE



KEVIN BURT
UNEMPLOYMENT INSURANCE
DIRECTOR, DEPARTMENT OF
WORKFORCE SERVICES



PHILIP S. LOTT
ASSISTANT UTAH ATTORNEY
GENERAL

cc: Senator Karen Mayne